State of North Carolina Debt Affordability

Presented by T. Vance Holloman

March 1, 2011

Debt Affordability Advisory Committee

About the Commission

The Committee is legislatively directed to:

- Annually advise the Governor and the General Assembly of the estimated debt capacity of the State (General Fund) for the upcoming ten years
- Annually advise the Governor and the General Assembly of the estimated debt capacity of the Transportation and Transportation Trust Funds for the upcoming ten years
- Recommend other debt management policies it considers desirable and consistent with the sound management of the State's debt

Study makes no recommendations regarding the use of available debt capacity.

Study is due February 1.

Debt Affordability Advisory Committee

Members of the Debt Affordability Committee

- Janet Cowell, State Treasurer
- Charles Perusse, State Budget Officer
- David Hoyle, Secretary of Revenue
- Beth Wood, State Auditor
- David McCoy, State Controller

Senate Appointees

- Stuart Bell
- J.W. Davis

House Appointees

- James V. Porto
- Jack Vogt

Review: What is Debt Affordability?

The amount of debt that may be prudently authorized and issued in a given period *without* negatively affecting the credit position or impairing the budget flexibility of the issuer.

- The amount of debt that is affordable ("capacity") is finite.
- Capacity can be measured and compared.
- Issuance beyond a prescribed level can erode credit ratings.
- The State measures its available capacity using tax-supported debt.

What is Tax-Supported Debt?

- The three bond rating agencies view all debt supported by state-wide taxes, fees, or levies as "tax-supported debt" and measure it on a combined basis. The measurement includes both General Fund and Transportation debt.

- For example, debt supported by both NC's Motor Fuels Tax and/or Vehicle registration and title fees would count as tax-supported debt.

- Debt supported by specifically pledged project revenues (e.g. tolls) would not count as tax-supported debt.

  OPEB and ESC obligations are excluded.

Outstanding Tax-Supported Debt by Type (at 6/30/2010)

General Obligation (GO) Bonds	
Highway Fund GO Bonds	$527.9
General Fund GO Bonds	$4,708.4
Total General Obligation Bonds	**$5,236.3**

Special Indebtedness	
Net Tax-Supported Special Indebtedness (Limited Obligation Bonds, COPs, Lease Revenue Bonds, Installment Purchase Contracts)	$1,375.6
Total General Fund Tax-Supported Debt	**$6,084.0**
GARVEEs	$434.8
Other (energy and other non-GF supported)	$450.3

(millions)

Authorized but Unissued Tax-Supported Debt (as of 2/16/2011)

Total	
General Obligation (GO)	$0.0
Special Indebtedness	$1,088.3
Total	**$1,088.3**

Purpose	
Universities	$544.2
Psychiatric Hospitals	$218.0
R&R Projects	$142.1
Correctional Facilities	$56.1
State Projects and other	$127.9

(millions)

2010 GA Session New Debt Authorizations

New Debt Authorizations	
Repair and Renovation Projects	$120
Equipment	$55
Total New Authorizations	**$175**

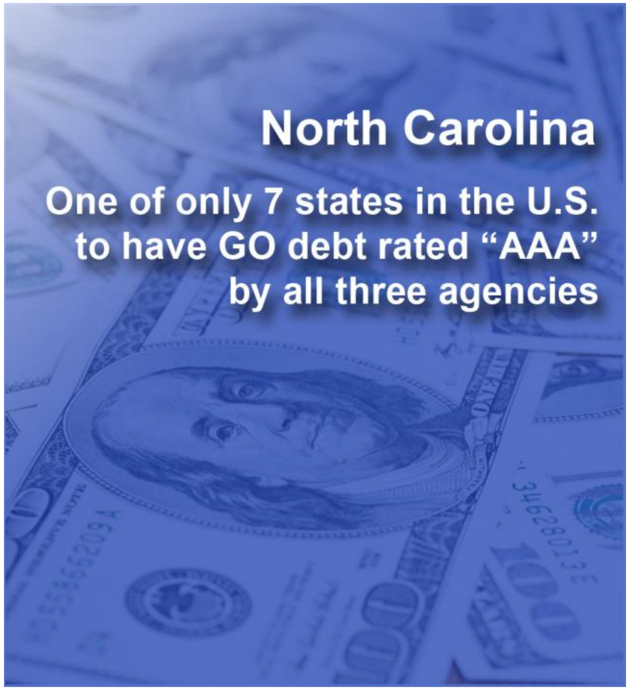
(millions)

“Triple-Triple A” States

“Triple-Triple A” States are those achieving the highest rating from each of the three major bond rating agencies.

Our peer group is comprised of these 8 states (including Iowa):

- Delaware
- Maryland
- North Carolina
- Virginia
- Georgia
- Missouri
- Utah
- Iowa*



** Iowa has non-GO debt rated “double A plus” and has been awarded an implied “AAA”.*

“AAA” States Debt Comparisons

State	Debt/Personal Income	Debt per Capita	DS % Gov Expenditures
Delaware	6.2%	$2,489	5.2%
Georgia	3.3%	1,120	5.3%
Iowa	.2%	73	0.7%
Maryland	3.4%	1,608	4.3%
Missouri	2.2%	780	3.0%
North Carolina	**2.3%**	**765**	**2.0%**
Utah	3.2%	957	3.9%
Virginia	2.1%	895	3.4%
Median	**2.8%**	**$926**	**3.7%**

Source: Moody’s 2010 State Debt Medians and S&P 2009 State Debt Review
Note: Rating Agency comparisons are historic in nature and do not include authorized but unissued debt.

Not “Apples to Apples”

- States develop debt affordability guidelines that are applicable to their individual situations and needs.
- Not all states utilize debt service as a percentage of revenues as the main metric, but a majority of the “AAA” rated states do.
- This calculation is most valuable because both numerator and denominator are directly controlled by policymakers.

GF Model Assumptions

- Tax-Supported Debt Service as a percentage of DAAC Revenues is the preferred calculation because both numerator and denominator directly controlled by policymakers.
  - 4% Guideline
  - 4.75% Ceiling

- Other Measures Evaluated:
  - Debt to Personal Income (2.5%/3.0%)
  - 10-year Payout Ratio (55%/50%)
  - Level of GF Unreserved Fund Balance and/or reserves
  - Debt per Capita

When NC adopted its limits (2003), policymakers were concerned that the State not become over-leveraged in a time of revenue uncertainty and negative fund balances.

In hindsight, that decision provided a measure of fiscal discipline that has served the State well in the current downturn and has helped it to regain its “AAA” rating from Moody’s in 2007 and maintain its “AAA” rating from Fitch and S&P.

February 2011 DAAC Study

North Carolina General Fund Tax-Supported Debt Statistics

Projected as of	Debt to Personal Income	Debt per Capita	Debt Service as % DAAC Revenues	10-Year Payout Ratio
6/30/10 (actual)	1.8%	$638	3.61%	59%
6/30/11	1.8%	$663	3.62%	63%
6/30/12	1.8%	$672	**4.12%**	66%
6/30/13	1.7%	$641	**4.22%**	70%

February 1, 2011 DAAC Study

General Fund Results

4%	2011	2012	2013	2014	2015
Total Capacity	$0.0	$0.0	$54.2	$314.2	$422.1
Annual Capacity*	$0.0	$0.0	$0.0	$0.0	$0.0
Actual Ratios	3.6%	4.1%	4.2%	3.9%	3.8%
Debt Service Overage		$21.5	$42.6		

** Amount available each and every year*

(millions)

Transportation Debt Capacity

- Highway and Highway Trust Fund capacity combined
- All State-level transportation revenues used (DOT projection)
- Federal revenues and GARVEES excluded
- Guideline adopted: transportation-related debt service should not exceed 6% of the State's transportation revenues

Transportation Liabilities

- Outstanding Highway General Obligations
- "Gap Funding" support for NCTA ($25 million - $112 million/year)
- P3 and/or "design/build/finance" obligations count depending upon revenue source
- **Transportation debt service is projected to exceed its limits and capacity has been exhausted until FY 2014**

February 1, 2011 DAAC Study

Transportation Results

	2011	2012	2013	2014	2015
Total Capacity	$0.0	$0.0	$0.0	$83.8	$161.0
Annual Capacity*	$0.0	$0.0	$0.0	$0.0	$0.0
Actual Ratios	6.2%	6.3%	6.5%	6.3%	5.8%
Debt Service Overage	$5.0	$8.9	$15.1	$8.4	

** Amount available each and every year*

(millions)

Tax-Supported Debt Burden

Combined General Fund and Transportation Tax-Supported Debt Burden

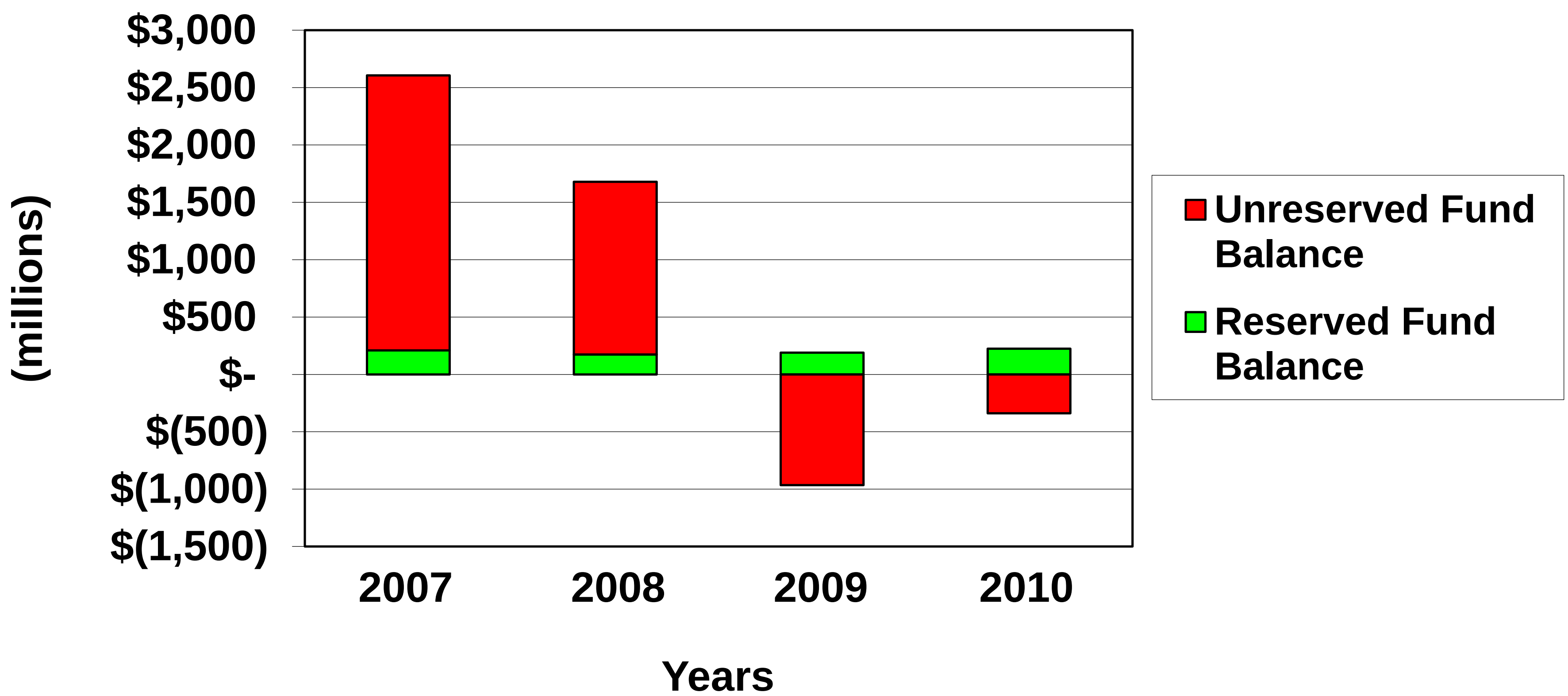
2013 actual projection	Target D.S. % Revenues*	Ceiling*
General Fund (4.22%)	4.0%	4.75%
Transportation (6.51%)	6.0%	6.0%
Combined Result (4.53%)	4.27%	4.92%

* Based on 2007 revenues

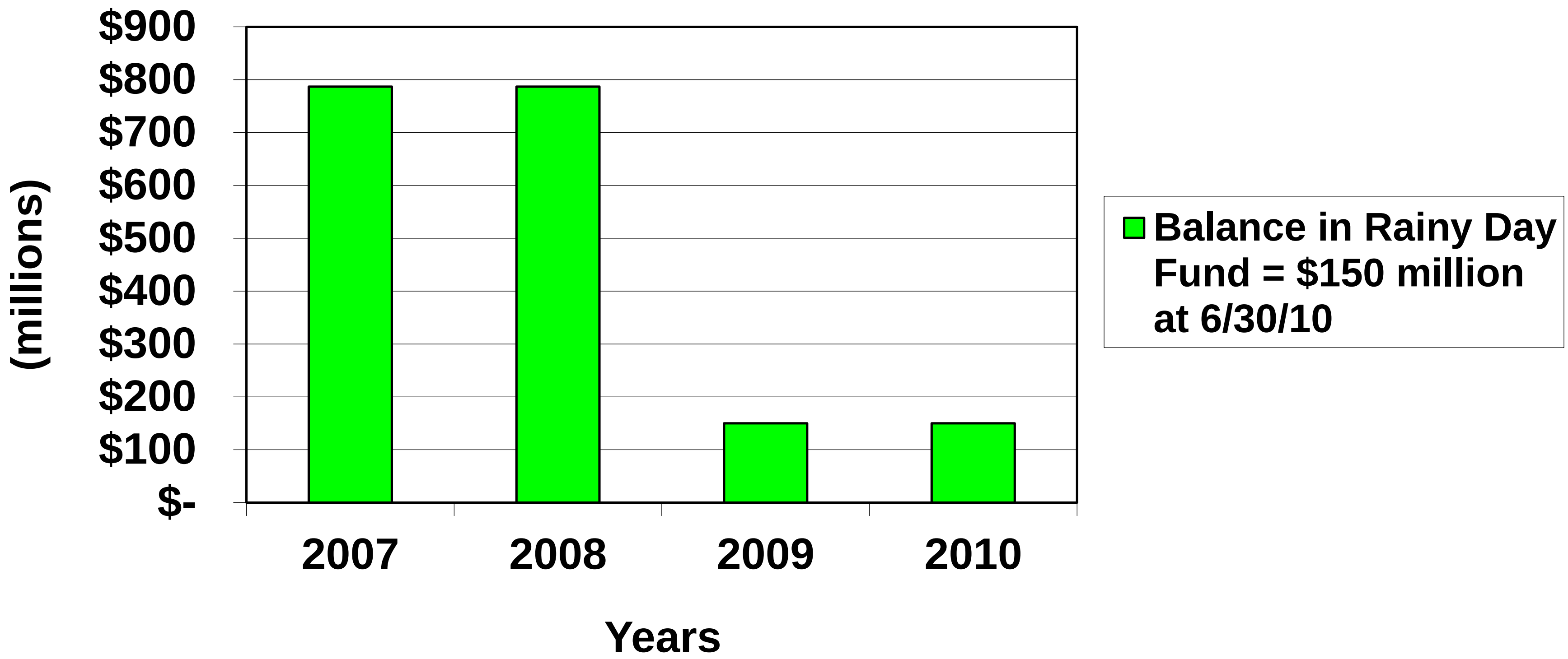
2011 DAAC Other Recommendations

- Achieve structural budget balance and replenish reserves.
  Tax reform may need to be considered.
- Establish a preference for General Obligation debt (versus special indebtedness).
- State should maintain its historically conservative debt management practices, including:
  - Centralized authorization, issuance and management of debt
  - Inclusion of all debt and debt-like obligations in calculations
  - GA clarification regarding individual agencies' ability to enter into alternative financings that may include debt and debt-like obligations
- Other Liabilities that do not impact debt capacity directly will need to be addressed:
  - OPEB
  - ESC Borrowings
  - Pension Funding

Structured Budget Balance and Replenish Reserves



Rainy Day Fund



General Obligation versus Special Indebtedness

- Since 2000, the State has relied extensively on the authorization of Special Indebtedness (Limited Obligation Bonds, COPs, other)
- Special Indebtedness as a percentage of all tax-supported debt will exceed 40% in FY 2014
- Peer group around 26%

Conservative Debt Management Practices

- Conservative Debt Management Practices include:
  - Centralized debt authorization
  - Centralized debt management and issuance
  - All debt and debt-like obligations counted in debt burden
- Recommendation is that General Assembly clarify its intent regarding individual agencies' ability to borrow by adopting limits, terms and taking into consideration the impact on debt burden.

Other Debt and Debt-Like Obligations

Debt Affordability Treatment

- Depends upon source of repayment
  - "General Governmental Funds" versus pledged revenue stream
- Public Private Partnerships
  - Financing costs higher
  - May count against debt affordability
  - Process to evaluate variables

Speed	Quality	Priority of Project
Control	Public Access	Financing Costs
	Compensation	

Other Liabilities

- The Committee recommended that the General Assembly determine the best course of action to address:
  - OPEB Liabilities
  - ESC Borrowings
  - Pension System Funding
- Although these liabilities do not impact debt capacity directly, they could have a negative impact upon the bond ratings of the State.

Thank you!

Together, we can build and maintain a fiscally strong and prosperous North Carolina.

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